RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Oct. 8, 1997 **LETTER 1236**

Sept. 26 DJIA 7922.18; PTI 5071; A-D Ratio +10.27
Oct. 3 DJIA 8038.58; PTI 5091; A-D Ratio +11.13
Dow Yield: 1.66%; Dow Price/Earnings: 21.2
Dow 144-day MA: 7549; Dow 34-day MA: 7917
Dow Times Book Value: 5.68; PTI 89-day MA: 4993
Percentage of Undervalued Blue-chips: 3%
Gold 144-day MA: 341

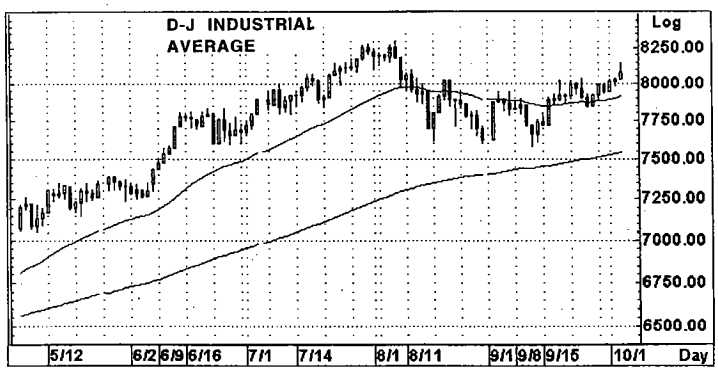
SNAPSHOT: Southeast Asia suffers new collapses in their currencies, their stock markets and their economies. Japan's Nikkei stock average sinks to a nine-month low as the Japanese economy stagnates. China floods the world with cheap, competitive goods. All the foregoing is DEflationary. The Fed must be taking the **deflationary** implications of all this into account and allows the US money supply to surge (above average money growth to counter-act global deflationary pressures). The US stock market, bolstered by strong bonds (bonds at new highs for the year) and a rising money supply on one side -- and world over-production and global deflationary forces on the other, fluctuates in **a high-level trading range.** Precious metals come to life, but this may be due more to a short squeeze than to any inflationary pressures (the silver stockpile is now extremely low and large demand for gold is coming out of Asia).

THE MARKET: In recent Letters I discussed the value of working with two moving averages, the longer-term or 144-day MA and the shorter-term or 34-day MA. I've stressed that it's very meaningful if the 34-day MA is positioned **above** the 144-day MA. That relationship is longer-term bullish. By the same token, when the 34-day MA is positioned **below** the 144-day MA, the two moving averages are then in the longer-term bearish mode.

With this in mind, let's examine the current Dow. The first thing to note is that the two moving averages (as they have been all year) are in the bullish mode with the 34-day MA situated ABOVE the 144-day MA.

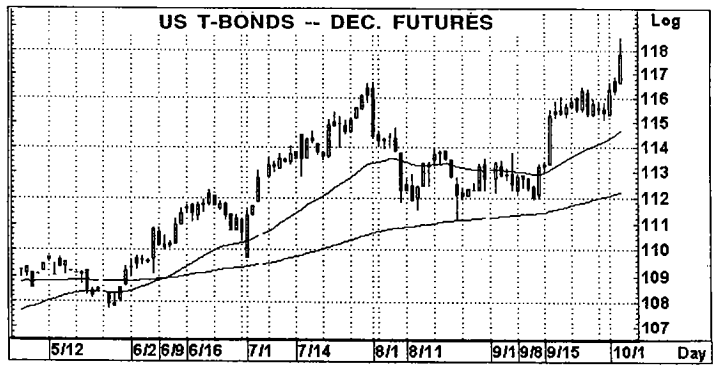
The next item to note is that the Dow has been hovering around the 34-day MA, rallying above it for a few days, then dipping temporarily below it.

Since mid-September the Dow has been holding above its 34-day MA, and thus the Dow must be labeled as bullish. The Dow will remain bullish as long as it holds above the 34-day MA which now stands at 7899. The D-J Transports are not a problem; they are in a strongly bullish mode.

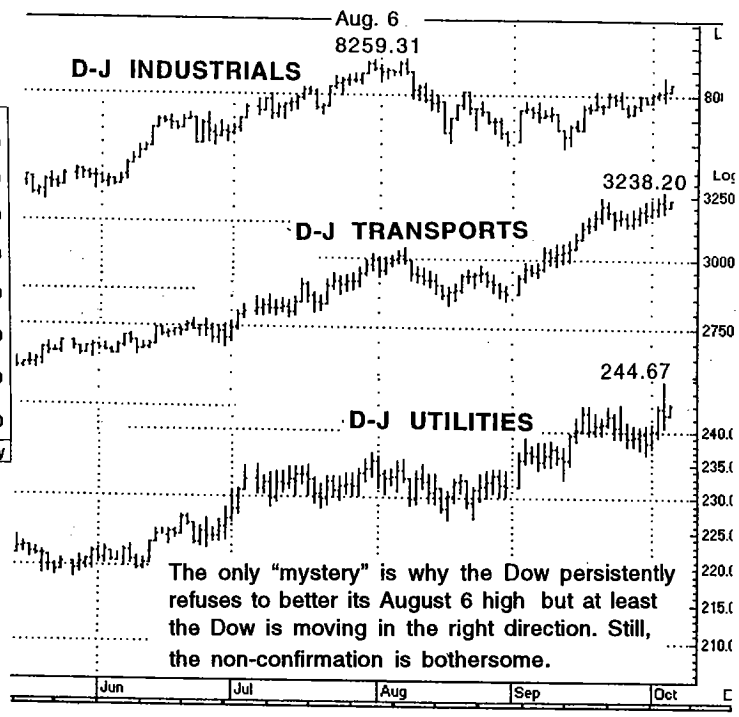


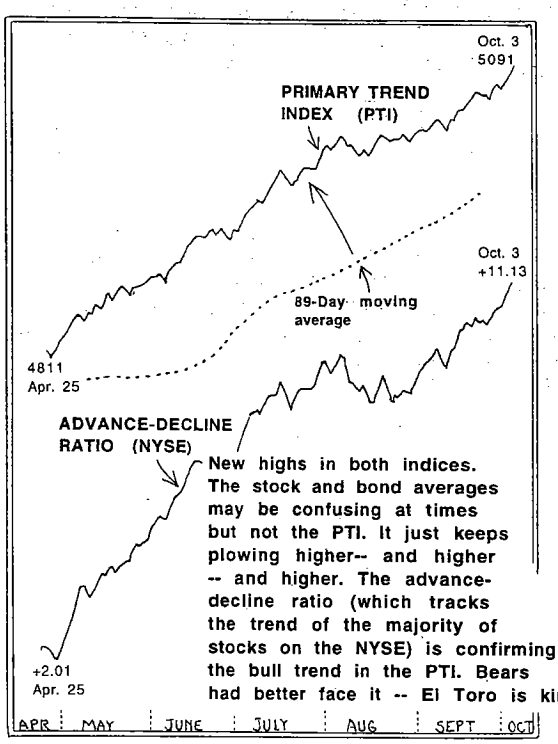
The December S&P futures have been acting a bit better than the Dow and are holding well above their 34-day MA. As subscribers know by now, the S&P futures set the trend for the market in the short term. As for the bond market, the December bond futures on October 2 rallied to a new high for the year -- and the long bond could now be headed for the 6.25% level or even the 6.00% level.

Conclusion: The market remains **bullish.** The stock market has been locked into high-level trading ranges since last July. But through it all, the public continues to buy the secondary stocks; this is evident because the advance-decline ratio has pushed to new highs, despite the fact that the Dow recorded its high back on August 6 at 8259.31. As this is written, the Dow is trading roughly 250 points under its record high.



The following fascinating and very telling comment is from S&P's *The Outlook*: "We estimate the portion of the earnings paid out in dividends, the payout ratio, will go to an all-time low of 35% on the S&P 500 for 1997. Companies are de-emphasizing dividends these days in favor of stock buybacks and other ways of lifting share prices. But even if the payout ratio was adjusted to the post-war average of 52%, the S&P 500's dividend yield, a key valuation measure, would be 2.55%, lower than at any point prior to the current bull market."

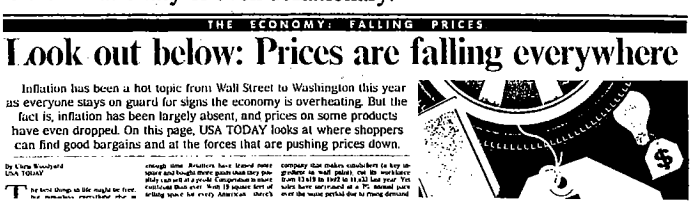



Oct. 3
5091
PRIMARY TREND
INDEX (PTI)
Oct. 3
+11.13
89-Day moving
average
4811
Apr. 25
ADVANCE-DECLINE
RATIO (NYSE)
New highs in both indices. The stock and bond averages may be confusing at times but not the PTI. It just keeps plowing higher-- and higher -- and higher. The advance-decline ratio (which tracks the trend of the majority of stocks on the NYSE) is confirming the bull trend in the PTI. Bears had better face it -- El Toro is king.
+2.01
Apr. 25
APR
MAY
JUNE
JULY
AUG
SEPT
OCT

THE PICTURE: In the last Letter I wrote about the rapidly expanding US money supply, a phenomenon which would normally be highly **inflationary**. But so far there are no overriding inflationary pressures in the US economy. This unique and abnormal situation has the Fed governors sitting on the edge of their seats (or easy chairs) searching for the first signs of inflation.

So what's the story? The story is this -- we, and the rest of the world, are experiencing powerful deflationary forces. There's very little pricing power (the ability to raise prices) in the US, and what pricing power there is -- is restricted to the financial markets, the leading auction houses, and, to some extent, the housing market.

But when you check out the retail stores you don't see prices rising (except in the very high-end merchandise, better known as what rich people buy). In fact, what you do see are sales, specials, rebates, discounts. When it comes to moving goods, any retailer will tell you that "it's a jungle out there." Some say there are too many shopping malls in the US, some say the whole country is simply "over-retailed." The strong dollar means that imported goods can be bought at a "discount" here in the US, and with current vicious retail competition, the bargains abound. The result is dis-inflationary or even deflationary.


THE ECONOMY: FALLING PRICES

Look out below: Prices are falling everywhere

Inflation has been a hot topic from Wall Street to Washington this year as everyone stays on guard for signs the economy is overheating. But the fact is, inflation has been largely absent, and prices on some products have even dropped. On this page, USA TODAY looks at where shoppers can find good bargains and at the forces that are pushing prices down.

Then there is the **deregulation** in industry after industry. Electricity, gas, telephones, TV satellites vs. cable -- the US consumer is besieged by calls from various corporations each offering to beat the other guy's price. Here in water-parched San Diego, five companies are waging a war to sell their wireless phones -- GTE, Airtouch, Sprint, Pac Bell and Nextel. The Sept. 24 *WSJ* headlines the story that Honda and Toyota will both be building new plants in the US. When the plants are completed, these two Japanese companies will be manufacturing a total of 2.5 million vehicles in the US, roughly the same number of cars that Chrysler produces (this in the face of a US that is already overflowing with new vehicles).

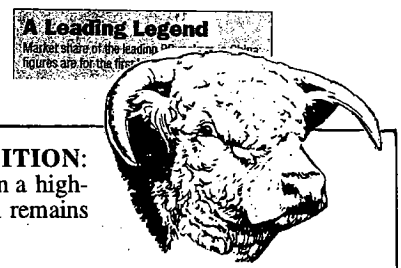
Finally, there is the Internet with its growing challenge to advertisers and its obvious advantages to bargain-minded buyers. Whatever you want, you name it, it's being offered at competitive prices on the Internet. With the Internet growing at the rate of 6% a month, it's only a matter of time before most of America's consumers are connected and tuned in. So, er, remind me not to go into the retail business. It's going to be a tough way to make a living.

As I said in the last Letter, the stock market has been enjoying the situation. An expanding money supply, a strong dollar, a powerful bond market (i.e., low interest rates) and no inflation. Do you remember the old Irving Berlin song which tells us, **"Let's face the music and dance."** Well, the music is the threat of inflation which the Fed is facing but which has not materialized. And the dance is what the stock and bond markets have been doing.

Note: Legend, a small Chinese computer manufacturing company, is now outselling all other computer makers in one of the world's largest potential markets -- China. This very significant piece appeared in last week's *WSJ* -- it tells of the Japanese and China's Legend Group forming a partnership which will bring out an under-$1,000 PC with a flat screen. Inside China the new computer will bear the Legend name; outside of China it will be an Hitachi. The article adds that, "The partnership could be bad news for US computer makers such as Hewlett-Packard, IBM and Compaq." **Russell comment:** As I see it, the Chinese industrial machine is just warming up, which will be bad news for a lot of industries, worldwide.

Chinese PC Maker, Hitachi Link to Fight U.S. Rivals

China's largest maker of personal computers clinched a deal with Japanese electronics giant Hitachi Ltd. that could give the Chinese company a technological edge against its U.S. rivals in one of the world's



INVESTMENT POSITION: Bonds strong, stock market in a high-level trading range -- the bull remains in the box.

Andrew Tobias has come out with a new book. His new book is entitled, "My Vast Fortune, the Money Adventures of a Quixotic Capitalist." Tobias writes, "My IQ and my net worth are the two numbers I try to keep to myself, being substantially lower than I'd like." Tobias, a well-known financial writer, wrote nine other books including the famous *"The Only Investment Guide You'll Ever Need."*

Tobias' advice is summed up in a few sentences, and amazingly, it doesn't differ substantially from the long-held Russell basic advice. Here's what Tobias says: "Make a budget. Scrimp and save. Pay off your credit cards. Quit smoking. Fully fund your retirement plan, and start early -- *tomorrow.* If you possibly can, put away $100 or $500 or $5,000 a month, whatever you can comfortably afford -- in two places: short and intermediate term Treasury securities, for money you might need in a few years; into no-load, low expense stock market 'index funds,' both US and foreign, for everything else. You will do better than 80 percent of your friends and neighbors." Writes the *NY Times* reviewer upon reading this book, "You are inspired, upon closing the book, to rush out and save your money."

Of course, what Tobias is really talking about is that eighth wonder of the world -- **compounding.** There is no system or phenomenon so calculated to generate wealth as compounding. For compounding, you must have (1) patience, (2) discipline, (3) the ability and fortitude to place your money in SAFE income-producing investments, and (4) time. Thus, compounding will do wonders for someone 25 or 35 years of age. If you are 65 or 75

compounding is going to be a lot less attractive (unless, of course, you're planning to live to 103).

The place where I might differ with Tobias is in buying index funds at this point. I would probably wait before buying index funds. Wait for what? A correction or a bear market. But right now, I would probably put my money partly into three-year T-notes and partly into long-term T-bonds. And wait -- patiently.

BONDS: This is a very long-term chart of bond **interest rates.** On a cold reading of the chart, it appears that interest rates have carved out a huge top. From a purely technical standpoint, this gives bond **rates** the potential to drop substantially lower. If we accept the most recent formation (since 1970) as one giant "head-and-shoulders" top, then on a technical "count," bond rates could ultimately collapse (incredible as it sounds) to the 4% area [chart courtesy of the *Leuthold Group,* (612)332-1567].

What could conceivably cause rates to sink to that low level? I'm thinking of two possibilities: **(1)** a severe recession, a recession which would cause the Fed to drive rates down through the floor as they move to thwart a bear market in stocks and a collapse in the economy. Or **(2)** a real deflation, brought on by competitive global devaluations (this is already happening), plus a vicious, all-out global battle for exports (this is beginning to happen).

Is that the hidden message of this chart? The two possibilities listed above sound rather outlandish, but with the US deficit moving dramatically lower, and with the government's issuance of long-term T-bonds shrinking drastically, who's to say that 4% rates on 30-year Treasuries will never appear? After all, did anyone in his right mind think that T-bond rates could surge to 15% in 1980?

Question: For years the stock market, via price/earnings ratios, has traded off of interest rates. If interest rates were to drop say below 5%, wouldn't the stock market go "through the roof"?

Answer: If the economy were to sink into a severe recession, the bond market and the stock market would almost surely de-couple. Stocks would sink, but interest rates on bonds (under pressure from a frantic Fed) would decline. After all, during the Great Depression of the 1930s the yields on T-bills dropped to a minuscule 0.5%, even while the stock market remained, for the most part, in a state of collapse.

There's one other factor which is now favorable for bonds. That is the shrinking US deficit and the resultant declining need by the US government to issue bonds. This chart shows the dramatic shrinkage in issuance of Treasury bonds since early '92 [chart courtesy of the *Aden Forecast,* (888)ADENMKT].

On October 2 the Dec. T-bond futures broke out to new highs. This was followed by a huge surge on Friday, Oct. 3 as non-inflationary news on the economy was released. The bonds have now rallied far above their July peak, putting long-rates in the 6.15% area and setting the bonds up for an attack on the critical (and psychologically important) 6% barrier. Breaking below 6% for the long bond would reconfirm the fact that bonds are in a powerful long-term bull market.

NOTES & QUOTES: Sandy Weill does it the right way. The Travelers takeover of Salomon was done with stock -- Travelers will issue 1.13 shares of its own stock for each single share of Salomon stock for a total value of $9.3 billion. Thus Travelers takes on no new debt and puts out no cash. Their only risk -- can Salomon pay its way?

And here comes WorldCom (who?) with a surprise bid of $30 billion for MCI. What are they bidding with -- surprise again, it's paper or er -- stock to be issued if or when the deal goes through. **Russell's rule:** The bigger the bull market, the more the paper.

* *

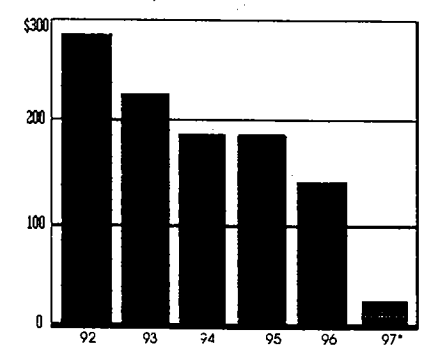
Yes, the good times are rolling in the US -- but a lot of consumers are having **too** good a time. Credit card delinquencies or accounts more than 30 days past due were close to a record 3.69% of the total in the second quarter of '97 (up from 3.51% in the first quarter).

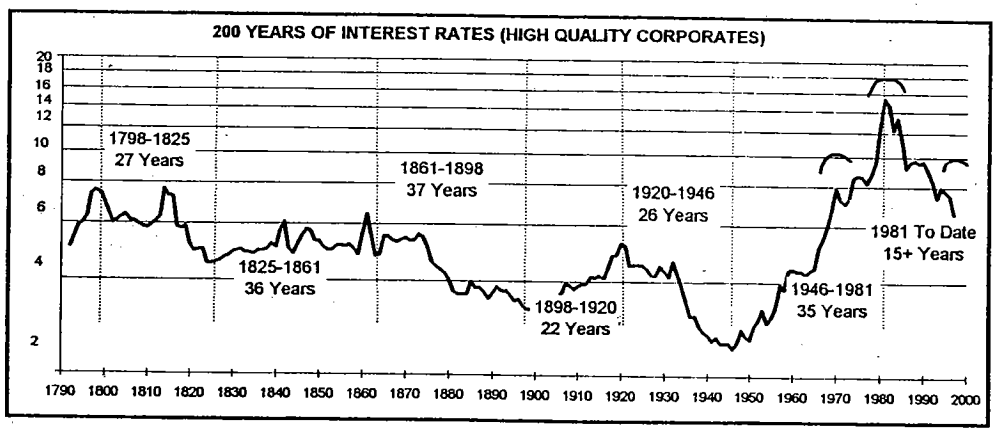
* *

The Liscio Report [(973)509-2256] is of the opinion that world conditions are definitely **deflationary.** Writes John Liscio: "The world has heard much about out-of-control inflation in China . . . China is in danger of lurching into deflation. The retail price index increased by just 1.1% in the first eight months of 1997, down from 5.7% in the first eight months of the same period a year ago. Month-to-month retail prices are dropping across the board . . . As it now stands, China's cheap exports to the US and other countries are depressing inflation and threaten to put most of the country's Asian neighbors out of business. Just last Tuesday, for example, China's top economic planners declared that they will follow the principle of 'survival of the fittest' and will reduce the number of wholly-owned state companies from 130,000 enterprises of varying size and function to 512 large, strategic ones." **Russell comment:** Privatization is sweeping China with thousands of government businesses being turned over to private interests. China is moving full speed towards capitalism, and in time this will translate into even fiercer global competition.

* *

What's the hottest of the world's major stock markets? Why, it's Italy, whose stock index this year is up over 33% in terms of dollars. Italy, the land where nobody pays taxes, Italy, whose tens of thousands of little businesses turn out much of the world's high fashion, Italy, the land of opera-lovers and great pasta and the Mafia -- Italy boasts a red hot stock market. But is Italy a bargain place to visit? No. My wife, Faye, on a business trip to Milan a few months ago, complained that it cost her $100 bucks to take a taxi from the airport to downtown Milan. So I'll stay in La Jolla, where I can get a top-quality, gourmet dinner for twenty-five US dollars or an all-you-can-eat salad bar for six bucks.





The last time I was in Italy was in 1944. I was flying out of Senigalia on the west coast of Italy near Ancona. My vehicle was a B-25 Mitchell Bomber. It was raw cold in early-April, and I spent my nights in a tick-invested, hand-me-down blanket roll (the previous owner, also a bombardier, had been killed in action the month before). At the time my squadron was mainly concerned with bombing, strafing, knocking out German positions, and most of the action was taking place at the strategic Brenner Pass (this was the battle of the Po Valley). It wasn't the happiest time of my life, and I told myself that if I lived through it all I never, ever wanted to see Europe again. They say time heals all wounds. After 30 years I finally changed my mind, and nine years ago Faye and I vacationed in Paris, a city that I really did enjoy. But somehow (and I know it's nutty) I'm still a bit prejudiced against Europe. I guess you never get a traumatic past completely out of your mind.

* *

What does it take to make a politician? And more specifically, what does it take to make an American president? For one thing it takes an almost manic will to power. It takes a huge ego. It takes a tough skin. It also takes quite a bit of snake oil plus the ability to prevaricate at the drop of a hat. In a fascinating article in last Sunday's *NY Times* magazine section, Harold Ickes, Sr., who was a close confident to Roosevelt, is quoted as calling FDR, "An opportunist. A liar. A politician." In 1994 Ickes' son, Harold Ickes, Jr., became confidant and clean-up man for Bill Clinton. The *Times* article notes, "Ickes had become caught up in so many of Clinton's scandals and crises that he came to describe his function in the White House as 'director of the sanitation department'."

Then, after countless hours of working for Clinton, "Ickes walked out onto the doorstep of his Georgetown house, picked up the *Wall Street Journal* and read that he was on the way out." The article continues, "The world is now heavily populated with Presidential victims -- people who feel betrayed by Bill Clinton, many of whom once considered Bill Clinton a friend." A *NY Times'* editorial calls Clinton a " charming rogue." People ask me, "OK, Russell, you cynic, let me ask you, who do you think was the last honest President?" I tell them a well-meaning nebbish named Jimmy Carter and before him an ex-haberdasher named Harry "give 'em hell" Truman. Sad to say, they were our last honest Presidents.

Of course, when it comes to politicians, I loved New York's Depression mayor, the "Little Flower," Fiorello LaGuardia. There was a tough, totally honest, little guy. New York adored him. When asked by reporters how he could possibly win running on an independent ticket, the Little Flower snapped, "I could beat those political tinhorns running on a laundry ticket."

Now NYC has another extraordinary Italian-American mayor, Rudy Giuliani. He's tough, he's honest, he drives around the city at night looking for trouble spots. He's a definite character. A fine piece in the October *Esquire* attempts to explain Giuliani. "Behind his back, they compare him to Mussolini. He removed the homeless from the subways and hid them. *Where are the homeless?* you hear them saying. *Those cops he's got control of, it's like a para-military force of 38 thousand* . . . He's a uniquely dark figure on the national state, so comfortable with his authority it scares people. He relishes power and stern discipline, and he doesn't seem ashamed to admit it. 'I've studied the careers of other politicians,' says Rudy, 'and they start off wanting to achieve things but lose their courage. They become placaters of the popular mood instead of having confidence that their ultimate goal is correct.' Rudy has been roundly booed on Martin Luther King day for a couple of years running . . . He's a *racist,* people said. *Cutting government, cutting welfare.* But lately things have been getting better. He gets hugged by strangers sometimes -- after all, the subways are clean, welfare workers are raking leaves in Central Park, Times Square has gone Disney, and the mob has been rousted from the Fulton Fish Market. And murder is down 60% in NYC since he took office, which means exactly that thousands of people are walking the streets alive, who given the statistics of four year ago, would have been dead by now." The article ends, "If Bill Clinton is the model of a modern politician, then it's hard to wrap your arms around Rudy. He is the Anti-Clinton." **Russell comment:** Which makes him my kind of guy. It almost (but not quite) makes me want to move back to Nooo Yawk.

* *

Speaking of New York, let's face it, Easterners hate California and love to predict the end of the West Coast as we know it. Fires, riots, hurricanes, land-slides, droughts, they're all played up in the Eastern newspapers. Now the East has a new horror-scenario for California, the dreaded El Nino (El Nino, by the way, means "the little Jesus"). The new El Nino is supposed to be the worst in 50 years, almost guaranteed to destroy the state of California. Already, roofers and gutter-repairers are going crazy with business here in S. California. So the good citizens of the Golden State, left bone-dry after 217 days with no rain, are hunkering down and readying for the Great Flood of '98. Actually, I've never seen anything (stock market, rain, snow, drought) that was this widely predicted actually come to pass. Therefore Richard Russell is going on record as saying that Easterners are going to be terribly frustrated when the worst storm in history doesn't materialize and El Nino becomes a bust.

But why, why do Easterners hate Californians so fiercely? Ah, the simple answer is that they're jealous. Living here in the Garden of Eden, I, an ex-New Yorker, can sympathize with denizens of the grimy East. Of course, you Easterners are jealous, and you have every right to be. Just as every software producer hates Bill Gates, every East Coaster hates California. But remember what I said, El Nino is surely just a fantasy dreamed up by the *New York Post* and the *Daily News*. It's not going to happen. But seriously, the fact is that San Diego has NEVER suffered a natural disaster (not true of LA or San Francisco). So let nature roll.

* *

Here's another reason why the East is jealous of the West. The East literally missed the whole recent technological revolution. While the West brought in the age of computers and Internet technology, West Coasters made millions and billions of dollars. With the garment and printing businesses now shadows of their former selves in NYC, we can call this "the bull market that saved New York.".

* *

Janet Reno is being dragged, kicking and mumbling, toward picking a special counsel to investigate what Al Gore and Bill Clinton did or didn't do in the money-raising frenzy that characterized the '96 election. If a special counsel is picked, I predict that all hell will break lose. I base this on what I've read regarding the raunchy duo's shenanigans to raise money. Ironically, however, the Republicans have done whatever they could to thwart real political reform. A plague on both parties. When it comes to money and the battle to retain office, there's almost nothing a politician won't stoop to. What are they so afraid of? After all, a pol can always quit and become a lobbyist. How are Clinton and Gore handling the whole thing? The way they always do -- pretend you know nothing, say you forgot, deride the issues, say everybody else did it, hire lawyers, and stall, stall, stall. And now the latest which comes under the concept of "the best defense is an attack." With unbelievable chutzpah Clinton on Sept. 23 threatened to force Congress to stay in session indefinitely this fall until members hold a debate and take a vote on campaign reform legislature. Republicans in Congress were furious that a president who may be investigated by his own Justice Dept. for fund-raising abuses could have the unmitigated gall to threaten them in the name of cleaning up the system.

* *

Speaking of pols, the currency mess and stock market collapse in Southeast Asia has curdled the hair of many an Asian politician. But the most flagrant and deceitful announcements have come from Malaysia's Prime Minister Mohathir last month when he called poor old George Soros a "moron" and accused him of being responsible for the collapse of Asia's currencies. Mohathir cynically has banned currency trading in Malaysia. I say cynically because Malaysia has been one of the world's biggest currency speculators -- three years ago the central banks of Malaysia lost roughly $3 billion in currency speculation.

* *

There's no business like show business. Well, maybe no business that's as tough. In LA last week the company producing "Rent" had five openings in the cast. A casting call went out, and 1,000 hopefuls showed up to try-out for the five parts. *The LA Times* called it "a ritual that amounts to a nerve-wracking and exhausting wait of several hours for a few moments or seconds in the spotlight."

* *

I used to drink five cups of coffee a day, but somewhere along the line I became allergic to caffeine. Even a cup of decaf in the morning will keep me hopped up all day. I've always believed that caffeine is a very powerful and addictive drug (I know it's a very strong diuretic). All of this hasn't stopped Starbucks from opening a few new stores every week. The army of coffee drinkers continues to expand, and even the kids are into it. But now there's a new wrinkle. Real coffee connoisseurs are buying coffee as if it was rare wine. Coffee freaks are buying coffee grown on particular estates. For instance, famed Blue Mountain coffee estates have received permission from the Jamaican Coffee Board to label their coffees by individual estates rather than just the generic name, Blue Mountain. Gad, what ever happened to that cup of java that I used to buy for a nickel?

* *

According to the National Retail Federation, more than $25 million of goods are shoplifted from US stores every day. Teens between 13 and 17 account for 30% of shoplifting, even though they make up only 7% of the population. Teen stealing amounts to $2.8 billion in losses every year. Why do they steal? Some do it for kicks, some do it because "they need it," some do it because it's "easy" and tempting, some do it compulsively, and some do it to show off. But they do it, and do it and do it.

* *

Nobody can accuse the Irish of being anti-the-fair-sex. Four women (and no men) are now battling for the presidency of Ireland.

* *

Spielberg, Geffen and Katzenberg have done something nobody has done in the past 60 years, they have started a new movie studio **DreamWorks.** Making films is the sexiest and riskiest business in the world, so how the new venture will turn out has Hollywood holding its collective breath. DreamWorks is a private company, and it is thought to have already accumulated around $1 billion in debt. The company has five divisions: live-action movies, TV, music, interactive and animation. DreamWorks already has 1,500 employees, half in animation. The DreamWorks partners say they hope to pay back their investors before their target date which is 2002. Many investors were wary of investing in DreamWorks, especially since the new studio lacks a library of TV shows and films, and libraries tend to cushion other studios. DreamWorks' first move has been released, "The Peacemaker." So far, it's been doing fairly well, but it's no blockbuster. On top of everything else, partner Jeffrey Katzenberg is suing Disney for $250 million. It's rumored that Disney's Eisner has no intention of paying.

* *

Independence At Last: On May of this year the Bank of England became an independent central bank, thanks (surprise) to the Labour government of Prime Minister Tony Blair. Up to '97 the "Old Lady of Threadneedle Street" had been controlled by the elected government. But in May England's central bank joined the parade of central banks that are now being run independent of their governments. One of the earliest of the banks to go independent was the Bank of New Zealand, which, in 1989, was granted independence by (surprise) another labor government.

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Get ready for major public action in stock index futures and options. The mini-S&P contract is out now, and this is a contract worth 50 times the price of the S&P, so at current prices this contract controls around $46,000 worth of stock. The new Dow futures will control ten times the price of the Dow so at current prices the Dow contract will be worth around $80,000. The public, which is familiar with the Dow, will be much more able to understand the Dow futures, consequently, I expect huge trading in this new contract. The Chicago Board of Trade, where the Dow futures will be traded, will devote one-third of its marketing budget towards boosting trading in Dow futures. Trading on the Dow contract began on October 6. To make it easy, stock brokers (and there are now 550,000 of them) won't have to study the more difficult agricultural contracts in order to take orders for the financial futures. But make no mistake about it, these smaller contracts are aimed at the public. The institutions will stay with the large S&P contract, which is priced at 500 times the S&P. Why? Because when you buy 10 small contracts instead of one large one the commissions add up. And when trading futures, commissions can become a major expense.

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The widely-circulated *Money* magazine (October's "Silver Anniversary Issue") is a study in greed and goofiness. The cover blares, "Get It All." Cover stories include, "Retire young the smart way," "Double your money in five years or less," and "Secure your family's future." A featured article is entitled, "America 25 Years From Now." This story tells us that in 25 years "America will in many ways resemble what you see right here: a snapshot of Hollywood, Florida. That's right, in 25 years." And we see a happy family, smiling amid flowers and palm trees.

I remember well the 1939 World's Fair, and one of the main exhibits at that Fair was the "City of Tomorrow." America's future city was shown as a delightful fantasy of well-planned streets, lovely parks, elevated freeways, uncrowded streets, trees, flowers, smiling people walking from store to playground to store. As you know, it never happened that way. In fact, it never even came close. The sad story is that nobody has any idea of what the US or the world will look like in 25 years or 10 years or maybe even in 5 years. But it's a very safe bet that the city of tomorrow is not going to look like Hollywood, Florida today. As a matter of fact, when I was a kid my family used to vacation in Hollywood, Florida. In the 1950s, Hollywood was a beautiful, small, upopopulated, no-traffic town. It's nothing like that today.

What struck me, however, was the unadulterated greed and "easy money" attitude of *Money*. I'm not a pessimist, but I know: (1) there's no easy way to make money; (2) there's no way to predict the future a year from now, much less 25 years from now; and (3) if there's a formula or secret to finding the pot of gold, you won't find it in *Money* magazine or any other magazine. The financial pot of gold comes from hard work, a lot of hard thinking, an adventurous disposition, and a goodly portion of luck.

Actually, there's only one sure way of ending up with real money that I know of -- it's compounding your savings in safe investments **through time.** I've been advocating this method for subscribers for almost 40 years. And I've received countless letters from subscribers thanking me for this one crucial bit of advice. If you want to generate real wealth, nothing, and I repeat NOTHING, is as **safe** or **sure** as **compounding your savings through time.**

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Mercedes Report: About four months ago I took delivery on the Mercedes 230 SLK, the little two-place convertible car with the metal top that folds into the trunk. I love the car, and so, it seems, do most women. Every place I go women stop to ooh and ah and tell me how beautiful the car is. The four-cylinder supercharged engine gives me plenty of speed, but I hear that Mercedes is already working on a six-cylinder version which will be out in Europe in a year or so. At any rate, I recommend the SLK to anyone who wants a fine (fun) little sports car; frankly, I like the SLK more than any car I've ever owned. Problem -- delivery for SLKs now runs into 1999. A friend just took delivery on the new Mercedes ML sport-utility car. I like it, it's smaller than most sport-utilities, and the base price is right around $35,000.

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Following the Senate investigation of abusive IRS practices, the IRS is pushing hard for public acceptance via monthly "open houses" in which the public can air their grievances. Why has the IRS turned "softy?" Because the specter of a flat tax or a consumption tax hangs over its head (either of which would mean

the possible elimination of the IRS). Meanwhile, the cartoonists are having a field day.

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There's no question but that the steadily rising stock market has had a huge effect both on consumers and on stock buyers. The "wealth effect" has caused consumers to spend a huge percentage of their after-tax income while sending their savings rate to the lowest level in decades. At the same time many stocks have risen to levels where they have discounted growth that almost surely cannot be sustained. Along these lines, I thought this Letter to the Editor of *Barron's* was so clear and logical that it bears study.

To the Editor

I read with great interest your article on Microsoft, having been short that stock for a while. I would like to add one element to your bearish piece.

What is truly amazing about the company's price/sales ratio is that it had peaked at an already enormous 10 times in early 1992. At the time, Microsoft was much smaller, with a market cap of "only" $25 billion for sales of $2.5 billion. With 20/20 hindsight, the growth prospects of Microsoft then were phenomenal. Today, as Richard Evans pointed out in his article, the software maker has a P/S ratio of 14. Over that period, its market cap has expanded from $25 billion to $160 billion (6.4 times in five years), but sales have climbed from $2.5 billion to a slower $12 billion (4.8 times). It's against the laws of nature (and of the economy) for a company to grow so much more in size than in valuation. Given the size of Microsoft, current holders and buyers of the stock are making quite a bet: that the company will be able to even do better now than it has done over the past few years.

ALBERT SAPORTA

PRECIOUS METALS: The mystery deepens. Have the precious metals really come to life? Is inflation just around the corner (you wouldn't know it from the bonds) -- or is there something else in the wind? Of course, the something else could be that the cheapest items on the face of the earth are gold and silver -- and with stocks becoming increasingly expensive, the metals are looking cheaper by the week.

In 1980, the Dow (at a price of 800) would buy a single ounce of gold or if you preferred, 16 ounces of silver. Here in 1997, the Dow (at around 8100) will buy 24 ounces of gold or 155 ounces of silver. Are the metals just too cheap to overlook, meaning that at these prices you just have to buy 'em and put 'em away? Of course, the trouble with that argument is that the metals have been "too cheap" for months -- not for years. So why would gold and silver suddenly want to adjust to a Dow that has increased ten-fold?

Answer: There is no single, clear-cut answer. All right, you insist on an answer -- over the last two weeks there were simply more buyers of gold and silver than sellers. For some unknown reason, the collective psyche of the market decided that it was time to buy the metals and they moved up.

But it wasn't just that they went up. No, gold rallied to its highest level since June, while silver surged far above both its 34-day and 144-day moving averages to its highest level since last March. At the same time, XAU, the Phila. Gold/Silver Average, completed and broke out of a huge "head-and-shoulders" bottom, an impressive move by XAU any way you look at it (see chart below).

Why has silver out-performed gold? Russell answer: Probably because silver, unlike gold, doesn't bear the risk of being sold (and knocked down) by central banks.

Question: If you were to take a position in gold shares, what would you buy? **Answer**: The strongest of the golds are Newmont Gold and Newmont Mining. American Barrick and Placer Dome would be my second choices. I also like TVX. Franco Nevada and Euro Nevada on the Toronto exchange have also been two of my favorites.

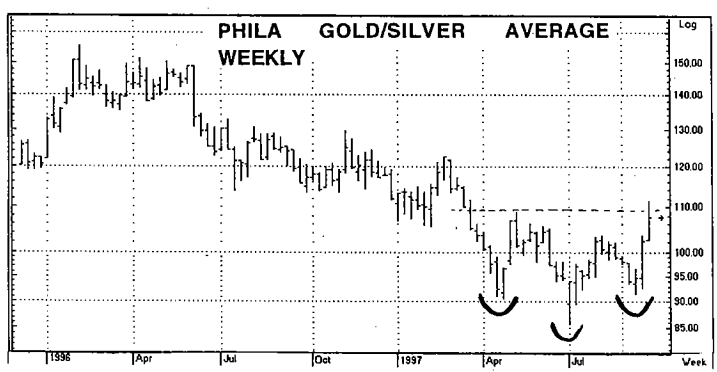
Russell Opinion: With gold and silver either declining or wallowing around for 17 years, it's psychologically difficult to reverse oneself and become bullish -- or even mildly optimistic about the metals. After all, much of the world is now in a deflationary mode, meaning that there are too many goods chasing a lesser amount of money

But wait -- supposing deflation really takes over, sweeping the world in its grip? What would happen then? Just what is happening in Southeast Asia --nations would devalue their currencies in an attempt to boost exports and revive business (actually, it would amount to an effort to export their deflation). In that kind of environment (i.e., devaluing currencies and almost surely expanding money supplies) gold would rise; in fact there could even be a panic for gold -- this would be particularly true if the dollar went into a major decline.

So it's a real enigma -- and remember, the reasons for a move are seldom known in advance. There has suddenly been buying in the precious metals and in the stocks. Buy 'em now? Honestly, I'm not convinced -- yet.

LATE NOTES: The stock market continues to discount the absence of inflation or maybe actual deflation (note the huge move in bonds over the past month). As bonds rise, long rates decline, adding value to stocks. Meanwhile, long rates in Japan's recessionary economy have dropped to a record low of 1.88% (why wouldn't the Japanese be buying US bonds?). The *ISI* Group quotes Jack Welch (CEO of GE), "There's excess global capacity in virtually every industry." *ISI* continues, "Pacific Rim currencies extended their declines last week, which, with a short lag, will allow them to place lower-priced goods on our markets. Asian weakness, both Pac Rim and Japanese, is already starting to show up." More *ISI:* "China's official media said one-third of all industrial products made in the country, ranging from radios to video-cassette recorders and TVs, were in over-supply and that many smaller factories could tumble into bankruptcy." **Russell comment: Let's face it, it's DEflationary. Deflation is flat-out bullish for bonds, but at some point ahead it's going to be bearish for stocks.**

Since August 6 the **dollar** has been in a downtrend, but I believe the correction is nearing an end. A newly strengthening dollar would be a major plus for the bonds.



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